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IN THE

Supreme Court of the United States

October Term, 1951.

No. 100.

THE UNITED STATES OF AMERICA,
Petitioner,

v.

HAROLD BLOOM, General Assignee for the Benefit of Creditors of PAVONE TEXTILE CORP.,
Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR THE RESPONDENT.

GUSTAVE A. DE LEMOS,
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On the Brief:
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THE UNITED STATES OF AMERICA, *Petitioner,* v. HAROLD BLOOM, General Assignee for the Benefit of Creditors of PAVONE TEXTILE CORP., *Respondent.*	No. 100.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF FOR THE RESPONDENT.

Statement.

Respondent concurs in the statement of the government as to the facts, except insofar as it interprets the decision of the Lower Court as "holding that Section 3466 of the Revised Statutes does not entitle the United States to post assignment interest" (R. 25-27).

The unanimous decision of the Court of Appeals, when stated in such negative fashion is thrown out of focus as to its true significance.

It is respectfully submitted that the decision of the Lower Court should be regarded in its more positive aspects which are as follows:

1. That the common-law rule against post assignment interest, in the absence of a statute to the contrary, is applicable in this case.

2. That the Federal Statutes concerning federal priorities, interest and interest rates, including U. S. Revenue Stat. Sec. 3466; U. S. Code tit. 26 Sec. 1420, sub. (b); Sec. 1627, create no exceptions to the common-law rule.

Summary of Argument.

Respondent will devote the first portion of the brief herein to an affirmative presentation of his contentions under the following points:

POINT I.

AS A GENERAL RULE, AFTER PROPERTY HAS PASSED INTO THE HANDS OF AN ASSIGNEE FOR THE BENEFIT OF CREDITORS, CREDITORS OF THE ESTATE ARE NOT ENTITLED TO POST-ASSIGNMENT INTEREST ON THEIR CLAIMS.

POINT II.

THE GENERAL RULE IS APPLICABLE NOT ONLY AS TO GENERAL CREDITORS, BUT AS TO PREFERRED CREDITORS AS WELL, IN THE ABSENCE OF A SPECIFIC EXCEPTION CREATED BY STATUTE.

The second portion of the brief will be dedicated to a direct refutation of the argument of the United States as follows:

POINT III.

SECTION 1420 (b) AND SECTION 1627 OF THE INTERNAL REVENUE CODE TOGETHER WITH SECTION 3466 OF THE REVISED STATUTES DO NOT CONSTITUTE A MANDATE FOR THE PAYMENT OF POST-ASSIGNMENT INTEREST AS CONTENDED BY THE UNITED STATES.

POINT IV.

APPLICATION OF THE GENERAL RULE AGAINST POST ASSIGNMENT INTEREST IN CONNECTION WITH NON-LIEN OR UNSECURED TAX CLAIMS IS NOT VIOLATIVE OF R. S. SECTION 3466 EVEN THOUGH UNDER SECTION 1420 (b) THE INTEREST IS ADDED TO THE TAX.

POINT V.

THE UNITED STATES HAS MISINTERPRETED THE RATIONALE OF THE RULING OF THE LOWER COURT AND THERE IS NO ERROR, AS CONTENDED, IN THE COURT'S DECISION.

The balance of the brief will consist of a presentation of the equitable and practical reasons for invoking the general rule:

POINT VI.

THE PAYMENT OF POST ASSIGNMENT INTEREST ON TAX CLAIMS IS NOT ONLY INEQUITABLE BUT ALSO CONTRARY TO THE ORDERLY ALMINISTRATION OF INSOLVENT ESTATES.

All leading to the

CONCLUSION.

THE CITED SECTIONS RELIED UPON BY THE UNITED STATES CREATE NO MANDATE FOR THE PAYMENT OF INTEREST IN ASSIGNMENT PROCEEDINGS UP TO THE DATE OF PAYMENT OF THE TAX. THERE BEING NO FEDERAL STATUTE TO THE CONTRARY, THE COMMON LAW RULE AGAINST POST ASSIGNMENT INTEREST IS APPLICABLE HEREIN AND THE LOWER COURT COMMITTED NO ERROR IN SO HOLDING.

POINT I.

As a general rule, after property has passed into the hands of an assignee for the benefit of creditors, creditors of the estate are not entitled to post-assignment interest on their claims.

A mere recital of the leading cases on the issue of post-insolvency interest, it is respectfully submitted, clearly establishes that interest, upon debts of an insolvent estate, stops after the property passes into the hands of a receiver or assignee. In the case of *Thomas* v. *Western Car Co.*, 149 U. S. 95, the Court stated (p. 116):

> "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. *Williams* v. *American Bank*, 4 Met. 317, 323; *Thomas* v. *Minot*, 10 Gray 263."

The rule was followed in the case of *Matter of People (Norske, Lloyd Ins. Co.)*, 249 N. Y. 139, with the concomitant qualification (p. 147):

> "* * * The rule that interest is not allowed after property of an insolvent has passed into the hands of an official liquidator applies only in the distribution of the proceeds of the property by the liquidator where the proceeds are insufficient to pay all creditors in full."

Obviously, where the fund is sufficient to pay all claims in full with interest, there is no reason why interest accruing during the liquidation should not be allowed.

The reasons for the rule which the Court of Appeals described as one of administration rather than of law, were cogently stated as follows (pp. 146-147):

> "'As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate.' (*Thomas* v. *Western Car Co.*, 149 U. S. 95.) Delay in the payment of a claim undoubtedly results in injury to the creditor. He does not receive full compensation unless interest is paid to him during the time in which payment of his claim is postponed. When the fund is insufficient to pay in full all the creditors who have the right to share in it, the burden of the consequent loss and injury should be equitably distributed among the creditors. * * * It is a rule of administration and not of law, for the law does not contemplate that a debtor may stop the running of interest until he has paid his debt. Interest continues to run against the debtor during liquidation; but on the principle that equality is equity, it has been held that all who have a right to share in the distribution of the fund in liquidation must bear equally the burden of the delay in the payment of their claims where the fund is insufficient to pay all in full."

In the case of *People* v. *American Loan and Trust Co.*, 172 N. Y. 371, further light is thrown on the reasons for the formulation of the general rule. The Court stated (p. 378):

> "* * * We agree with the learned Appellate Division that the statutory 'provision was made with

> the intention that the preference should take effect at the time at which all claims against the corporation would be presentable, and that it was not the intention of the legislature to allow either contractual interest or interest as damages to run on indefinitely through all the protracted proceedings that might continue, as they did in this case, for many years after the court took possession of the assets for the purpose of making distribution of them'."

In the case of *City of New York* v. *Saper, Trustee in Bankruptcy,* 336 U. S. 328 (fols. 25-31), the City of New York, the State of New York, and the United States of America, sought to enforce payment of their respective tax claims with interest to the date of payment. While the proceedings were in bankruptcy, the United States Supreme Court, among other things, affirmed the general rule. Mr. Justice Jackson delivered the opinion of the Court, and stated (p. 330) (R. 6):

> "If the question were one of first impression to be decided in the light of the present statute alone, we should have no difficulty in affirming the court below. More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle, of the English bankruptcy system which we copied (*Sexton* v. *Dreyfuss,* 219 U. S. 33, 344)."

(p. 332):

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankruptcy Act."

It is not disputed that the funds in the case at bar are not sufficient to pay the claims of all creditors with interest to the date of payment. Accordingly, the general rule providing for the termination of interest upon the filing of the assignment should be applied to the tax claims of the United States of America.

POINT II.

The general rule is applicable not only as to general creditors, but as to preferred creditors as well, in the absence of a specific exception created by statute.

The question as to whether or not the general rule is applicable to both preferred and unpreferred creditors was squarely presented in the case of *People* v. *American Loan and Trust Co. supra.* By the charter of the American Loan and Trust Co., it was provided that in a proceeding for the dissolution of the corporation the debts due to the company as guardian, receiver or depository of money in Court or of savings bank funds were to have a preference. When the company failed to meet the demands of payment of the deposits of the appellant savings bank, the Superintendent of Banks took possession. A receiver was appointed and the corporation was dissolved. The savings bank along with some other creditors presented claims to the receiver as preferred creditors, which he allowed with interest at the contractual rate to the date of suspension. Payment was made by four successive dividends, the last dividend stating that completion of the payment of principal was thereby being made. On the final accounting, the appellant savings bank and a receiver of the preferred creditor claimed they were entitled to post assignment interest. The questions certified by the Court were as follows (pp. 376, 377):

"'Are the appellant Savings Banks, or any of them, entitled to receive before payment of any dividends of the unpreferred creditors, any interest upon their deposits, demands or claims against the American Loan and Trust Company * * *'?"

* * * * *

"'Is the appellant Thomas P. Wickes, as receiver of Coffin & Stanton, entitled to receive before payment of any dividend of the unpreferred creditors any interest upon his claim against the American Loan and Trust Company? * * *'"

The Court stated (f. 377):

"As questions relating to interest are liable to arise so frequently in the settlement of the affairs of insolvent corporations, we adopt the broad, simple and just rule laid down in substance by the Appellate Division, that while interest is allowed as against the corporation itself, or its stockholders, if the assets are sufficient for the purpose, as between preferred and unpreferred creditors no interest is allowed after the law takes charge through the appointment of a receiver."

The Court went on to state (p. 379):

"* * * Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets." * * *

In the case of *United States Fidelity & Guaranty Co.* v. *Carnegie Trust Co. et al.*, 146 N. Y. S. 801, 161 App. Div. 429, a trust company, designated by the City Comptroller as a depository, went into liquidation. On demand, the surety company paid the amount of its liability to the

Comptroller and took an assignment of the Comptroller's claim against the bankrupt. The Court held that the surety company was entitled to a preference, but not as to interest as to which it was entitled to be paid, only ratably, with the claims of unpreferred creditors on the authority of *People* v. *American Loan and Trust Company, supra.*

For similar application of the general rule against post assignment interest in other jurisdictions, see:

Leach v. *Sanborn,* 231 N. W. 497;
American Casualty Ins. Co.'s case (*Boston & A. R. Co.* v. *Mercantile Trust & D. Co.*) (1896) 82 Md. 535, 38 L. R. A. 7, 34 Atl. 778;
Atty. Gen. v. *Supreme Council, A. L. H.* (1910) 206 Mass. 131, 92 N. E. 134;
Fordye v. *Kansas City & N. Connecting R. Co.* (1906; C. C.) 145 Fed. 566;
Atlanta Nat. Bank v. *Four-States Grocer Co.* (1911; Tex. Civ. App.) 135 S. W. 1135.

The case of *Leach* v. *Sanborn, supra,* which rested on the authority of *People* v. *American Loan & Trust Co., supra,* was followed in *Cutler* v. *Horgen,* 234 N. W. 238, 213 Iowa, 983, where the general rule was stated. The Court held:

> "The evidence shows that there were not sufficient funds in this estate to pay the creditors in full, with interest on the claims. We have held that, in insolvent estates where this condition exists, creditors, even preferred creditors, are not entitled to interest."

POINT III.

Section 1420 (b) and Section 1627 of the Internal Revenue Code together with Section 3466 of the Revised Statutes do not constitute a mandate for the payment of post-assignment interest as contended by the United States.

The Government contends that the decision of the Court below is in conflict with the priority conferred by Section 3466 of the Revised Statutes. It is argued that the priority of payment to be accorded the United States in non-bankruptcy proceedings, makes it mandatory that the government be paid its tax claims, with interest to the date of payment.

The applicability of the statute has never been challenged by respondent; nor has it been denied by the Court below. On the contrary, the Court of Appeals specifically stated in rejecting the Government's claim for post assignment interest (R. 25):

> "We are reinforced in this conclusion by the language of the Federal priority statute, which clearly has application here * * *."

Concededly, Section 3466 is determinative on the question of the order of priority in the State Court. It is not contended that the United States is limited to the same priority in assignment proceedings as it has in bankruptcy proceedings. Respondent recognizes that the law is well-established that Section 3466 has not been affected by any of the bankruptcy enactments, and that, therefore, Federal debts shall first be paid before other claims in State Court proceedings. What is disputed, however, is the erroneous belief that the definition of the word "priority" embraces

the requirement that the Court shall award post-assignment interest in derogation of the general rule.

In demanding post assignment interest, Petitioner seems to have lost sight of the fact that Section 3466 simply establishes an order of payment of government claims without defining what is meant by a claim. There is nothing in the statute which directs the payment of post-assignment interest in contravention of the common law rule.

To bolster its contention that the payment of post-assignment interest is mandatory the Government points to Section 1420 (b) of the Internal Revenue Code and seizes upon the words "until paid" as evidence of such legislative intent. So much of the section as is pertinent provides:

> "(b) *Addition to Tax in Case of Delinquency.* If the tax is not paid when due, there shall be added as part of the tax interest * * * at the rate of 6 per centum per annum from the date the tax became due until paid."

If the language, "until paid", was formulated for the express purpose of nullifying the existence of a common-law rule against post-insolvency interest, it is difficult to understand why, in simple and direct language, Congress did not provide for its collection in so many words.

Significantly enough, on page 18 of its brief, the United States anomalously states: "If, as the language of Section 1420 (b) *seems plainly* to say, the interest until date of payment of the taxes became part of the taxes, * * * that interest, as taxes, was a debt due the United States under Section 3466 of the Revised Statutes." (Emphasis added.)

That the statute "seems plainly to say", can only mean that the statute needs be interpreted. On that score, the

Court in the case of *Old Colony R. R. Co.* v. *Comm.*, 284 U. S. 552, stated at page 561:

> "If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale most favorable to the taxpayer" (citing cases).

The very wording of the statute is persuasive of the fact that its ostensible purpose is simply to provide for:

a. The creation of an interest charge;

b. The manner of its collection; and

c. The amount thereof.

There is nothing in the statute to indicate that a Government claim for taxes, once the taxpayer's property is in custodia legis or in the hands of an assignee under statutory provisions, does not fall within the prevailing rule against the payment of post-assignment interest.

The words "until paid" should not be taken out of context, and freighted with a significance beyond their normal definition.

If the statute has for its purpose the payment of interest under all circumstances, how is the bankruptcy statute which limits post bankruptcy interest to be reconciled with it? Obviously, a new set of rules comes into play when the tax debtor becomes insolvent.

In the case of bankruptcy, the bankruptcy act applies and, were there no specific statute in existence to govern the question of post-bankruptcy interest, the common-law rule, in the absence of a specific statutory prohibition against such interest, would operate to suspend the payment of interest after the filing of a petition. *City of New York* v. *Saper*, 336 U. S. 328.

As to assignment proceedings, a similar common-law rule developed independently of the bankruptcy rule. *Thomas* v. *Western Car Co.*, 149 U. S. 95, 116-117; *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 379, motion for reargument denied 177 N. Y. 467; *Matter of People (Norske Lloyd Ins. Co.)*, 249 N. Y. 139, 146-148; *United States Fidelity & Guar. Co.* v. *Carnegie Trust Co.*, 161 App. Div. 429, affd. 213 N. Y. 629; *Matter of Murray*, 6 Paige Ch. 204.

Special rules have always existed with respect to insolvent estates. Many of them evolved out of experience and practical requirements. Thus, if the Government's interpretation of the cited statutes be correct, its claim would be paid even before the expenses of administration. Yet, it cannot be seriously contended that the cited statutes are applicable to expenses. Such application of the statutes would soon make a shambles of a procedure which has for its salutary purpose, the conservation of the assets of a debtor for the benefit of all creditors, including the U. S. Government.

The lower court was not unmindful of the language of Sections 1420 (b) and 1627 and saw in it no abrogation of the general rule against the payment of post assignment interest; it stated that due effect are given the statutes by allowing interest to the time of filing the assignment.

Accordingly, there is no conflict between the decision of the Court below and the operation of the priority established under Section 3466. As a matter of fact, the ruling of the Court below now does for state insolvency proceedings, what this Court did for bankruptcy proceedings. In each case, the Court recognized the existence of a priority for tax claims and, applying the common law rule of non-payment of interest, arrived at like determinations for the same reasons.

The rulings are in harmony with what is just and equitable. In the words of the Court below (R. 27):

"The rationale of the authorities hereinbefore cited is sound; they follow the long-established common-law rule, since no statute provides for the payment of post-bankruptcy or post-assignment interest; they harmonize the rules in bankruptcy and assignment proceedings; and they achieve a result that is just, fair, and equitable. To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding, and thereby consume all or much of the funds available, to the detriment of the other creditors, is in accord with neither law nor equity."

POINT IV.

Application of the general rule against post assignment interest in connection with non-lien or unsecured tax claims is not violative of R. S. Section 3466 even though under Section 1420 (b) the interest is added to the tax.

The United States argues at considerable length and in great detail in support of its contention that United States tax claims are debts within the definition of R.S. Section 3466 and are therefore entitled to priority of payment in assignment proceedings. The issue is not to be thus confused, for Respondent has no quarrel with that proposition. When, however, the United States urges that a suspension of the running of interest on tax claims would run contrary to Federal statutes, respondent does take issue.

Under its second point, the United States starts with the faulty premise that the payment of post-assignment interest is a debt due the United States under Section 3466 of the Revised Statutes and is entitled, therefore, to the

same priority of payment as is accorded the tax itself under that section.

It does not follow as a matter of logic that the provisions of Section 1420 (b) alter the character and nature of interest by making of interest on unpaid taxes something to be "added as part of the tax". Its method of collection, by adding the interest to the tax, is not to be confused with the intrinsic nature of interest.

It is elementary that interest is no more than compensation for the use or forbearance of money. The term "interest" in the tax law has the usual, ordinary and everyday meaning given to it in the business world. In the case of *Old Colony R. R. Co.* v. *Comm.*, 284 U. S. 552, the Court stated (p. 561):

> "In short, we think that in the common understanding 'interest' means what is usually called interest by those who receive the amount so denominated in bond and coupon, and that the words of the statute permit the deduction of that sum, and do not refer to some esoteric concept derived from subtle and theoretic analysis."

The essential character of interest on taxes was recognized in the case of *Scripps* v. *Comm.*, 96 F. 2d 492, where it was treated as interest on an indebtedness and held to be deductible. And even though the tax itself is not deductible, interest thereon is. See *Evens & Howard Fire Brick Co.*, 8 B. T. A. 867. Thus it is clear that interest is not truly the equivalent of the tax on which it is due even though added to it.

Since a tax is a debt—nothing more—as such, it stands on an even keel with debts due to other creditors with the exception of a priority of payment as required under R.S.

Section 3466. In the case of *In re Union Fabrics, Inc.*, 73 Fed. Supp. 685, on page 687, the Court stated:

> "To treat tax claims, so far as interest is concerned, differently than other claims, I think is neither logical, sound nor just. On the contrary such treatment is a clear anomaly and cannot be justified except upon precedent now of doubtful validity since the passage of the Chandler Act. See *People* v. *American Loan Trust Co.*, 172 N. Y. 371, 379, 65 N. E. 200. Such ruling compels payment, not by the debtor whose debt it is but by general creditors who did not incur it, and who were not responsible for the delay in payment, out of their otherwise fractional recovery on their own claims."

R.S. Section 3466 does not require more than that the debt shall be first satisfied. Since a taxpayer is a debtor and the Government a creditor, that which is owing is clearly a debt, subject to the same rights and obligations that any other debt of an unsecured creditor is subject to, the only distinction being that a tax claim is entitled to a priority of payment. So is a wage earner, but he gets no interest after the date of the assignment. If a debt is accorded a priority and receives no interest, why should a tax claim receive interest merely because it has priority of payment of the debt?

Interest although collectible with the tax and added as part of the tax is not a tax; it is no more than compensation for the use of money or damages because of delay in payment of a debt due.

In the case of *Penrose* v. *United States*, 18 Fed. Supp. 413, where the question arose as to whether interest is a tax permitting its deduction in an estate proceeding, the Court ruled that interest is not a tax. If it is not a tax

then it is not entitled to priority of payment as a tax claim is.

It has been assumed by the United States, that "payment in full" of the tax claims herein necessarily means payment of both principal and interest to the day of payment.

In the case of *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 65 N. E. 200, the Court held that the priority granted to savings bank depositors under a statute was limited to principal although the pertinent section provided for "payment in full" of the deposits. In that case there were both preferred and unpreferred creditors.

In the case of *Matter of People* (*First Russian Ins. Co.*), page 253 N. Y. 365, the Court stated (p. 367):

> "There is indeed a general rule in the distribution of estates that from the time when the assets have been subjected to the administration of the law, interest ceases to run in favor of any creditor who seeks a share of the assets as a beneficiary of the trust, if the result of the allowance of such interest will be to prefer him over others." (*Matter of People* [*Norske Lloyd Ins. Co.*], 249 N. Y. 139.)

Finally in the case of *Hammer* v. *Tuffy*, 145 F. 2d 447, the Court stated (449):

> "• • • The New York Court of Appeals in *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 65 N. E. 200, held that the priority granted to savings banks deposits by Sec. 130 of the Banking Law of 1892 was limited to principal, although the section gave priority 'to the payment in full' of the deposits. This seems to be the generally accepted doctrine when the question arises between two

> groups of creditors, one of which is entitled to priority by statute or otherwise. Whether or not the priority is stated to be until the group is 'paid in full', the measure of the preference is the payment of the principal. We have collected a number of the cases in the margin. *Thomas* v. *Western Car Co.*, 149 U. S. 95, 116, 13 S. Ct. 824, 37 L. Ed. 663; *Taylor* v. *Corning Bank & Trust Co.*, 185 Ark. 691, 48 S. W. 2d 1102; *In re Pacific Coast Building-Loan Association*, 15 Cal. 2d 134, 99 P. 2d 251; *Squire* v. *American Express Co.*, 131 Ohio St. 23, 2 N. E. 2d 766; *In re Prudential Trust Co.*, 244 Mass. 64, 138 N. E. 702; *Federal Deposit Insurance Corp.* v. *Department of Financial Institutions*, 113 Ind. App. 14, 44 N. E. 2d 992."

But even if a point of view most unfavorable to respondent be adopted, nevertheless, as the lower court held:

> "Finally, statutes making interest a part of the tax (such as * * * U. S. Code, tit. 26, Sec. 1420, subd. [b]; Sec. 1627) are given due effect by allowing interest to the time of filing the assignment; thereafter the general rule as to post-assignment interest prevails in the absence of any statute expressly providing for such interest" (R. 27).

Satisfied with its conclusion that since a tax is a debt and since under Section 1420 (b) interest is the equivalent of the tax itself and therefore also a debt, the Government proceeds to invoke Section 3466 to establish the existence of a priority for interest.

The application of Section 3466, in the manner sought by the Government, is initially dependent upon the strained construction placed upon Section 1420 (b). Nor can citation of authority be of comfort to the Government when

it is based on practices which this Court, in the *Saper* case, pointed out resulted from a misinterpretation of the law. Needless to say, abundant instances can be cited where interest was paid merely because the issue was never raised. The value to be placed on such cases, as precedents, was aply stated in the case of *People* v. *American Loan & Trust Company*, 170 N. Y. 371. On page 380 the Court said:

> "* * * Questions relating to the allowance of interest upon preferred claims have usually been regarded as of such slight importance as to receive scant attention in the reported cases, and to rest upon the mere announcement of the result. When a question slips through the courts without discussion or anything to indicate deliberate judgment, the decision is not of great value as an authority, at least until it has stood the test of citation without criticism. This was the method of decision so far as the question of interest was concerned in *Upton* v. *New York & Erie Bank* (13 Hun 269, 273) and *Matter of Patterson* (18 Hun 221, 224). While we decided the latter case upon the opinion of the General Term (78 N. Y. 608), reference to that opinion shows an able discussion of a question not now material and a statement that no question was made in that court in relation to interest. If the question was not raised in the court below, we were at liberty to disregard it. We decided nothing but what the General Term decided, and as it did not pass upon the question of interest, because it was not raised, we did not."

POINT V.

The United States has misinterpreted the rationale of the ruling of the Lower Court and there is no error, as contended, in the Court's decision.

The Government concludes its arguments under its second point by urging that the Lower Court, in failing to cite a federal statute as creating an "exemption" of post assignment interest, was without basis for its ruling. It ascribes the Lower Court's "error" to the following factors: (a) In interpreting the language of Section 3466 making applicable to assignment proceedings the interest rules applicable to the bankruptcy act; (b) In holding that *New York* v. *Saper* (supra) requires disallowance of interest in assignment proceedings; and (c) In applying the general rule to Government claims in assignment proceedings.

Once more the Government reasons from a fallacious premise. It states that the Lower Court consigned "the federal priority in assignment proceedings to the same status the United States has for its claims in proceedings under the Bankruptcy Act".

Mere reference to the language of the decision and the reasonable inferences that flow therefrom disprove this contention. The decision, first, recognizes the existence of the general rule and then that the rule applies as between preferred and unpreferred creditors. It then makes reference to the decision of this Court in *City of New York* v. *Saper* (supra), as well as other authority, all in support of *the existence of a common-law rule both in State and Federal proceedings.* It then proceeds to recognize the applicability of Section 3466 to State Court proceedings with respect to the priority attaching to Government claims,

pointing out that "debts" in the statute has been held to include taxes, citing *United States* v. *Waddill, Holland & Flynn, Inc.*, 323 U. S. 353. It is the sentence following this citation that seems to have misled the Government as to the import of the Court's decision. The Court stated:

> "The statute clearly extends the federal priority in Bankruptcy proceedings to assignment proceedings, and inasmuch as the priority in bankruptcy does not include post-bankruptcy interest (*City of New York* v. *Saper*, supra) so the priority in assignment proceedings does not include post-assignment interest" (R. 26).

The words "inasmuch as" have been construed by the Government as equivalent to the word "because", so that on the interpretation of the United States the court seemed to have found that *because* of the fact that interest is not paid beyond the date of a bankruptcy petition, therefore, interest does or should terminate at the time of the filing of an assignment. However, the words "inasmuch as" are susceptible of definition synonymous with "in like degree as" or "insofar as." (See Funk & Wagnall's New Standard Dictionary of the English Language.) In short, the Court was merely drawing a comparison rather than a cause and effect conclusion. That such is the case becomes more apparent from additional language in the decision. "Precisely as did the United States with respect to bankruptcy, as indicated in the *Saper* case (supra), so has New York indicated that as to post-assignment interest it is to be treated on a par with other creditors" (R. 26). It is true that a comparison is drawn between the State assignment statutes and Federal bankruptcy Act, but only to point up how closely they parallel each other and not for the purpose of imposing the bankruptcy rules on State Court Practice.

The *Saper* case (supra) is cited twice, once to demonstrate the existence of a common-law rule implicit in the bankruptcy system and, again, to demonstrate that just as the case has resolved the post bankruptcy interest question, so have the Courts of New York done the same with respect to post assignment interest. Consequently it is apparent that the *Saper* case, in its bankruptcy aspects, was not invoked by the Lower Court for the disallowance of interest in assignment proceedings.

Respondent takes sharp issue with the Government as to the significance of the *Saper* case.

In the case of *City of New York* v. *Saper, supra,* the Court on page 330, after having stated the general rule, said:

> "Our present statute contains no provision expressly repudiating that principle or allowing an exception in favor of tax claims."

In the absence of a statute creating an exception in favor of tax claims, the general rule terminating interest remains applicable. It becomes important, therefore, to ascertain whether or not tax claims, as to interest, have been given a special status. Since Section 3466 makes no specific reference to interest, the question presented is: what is the nature of a tax claim and does it automatically fall within an exception to the general rule of non-payment of post-assignment interest?

It is the government's contention that Federal legislative enactment would be required to limit the payment of interest to the date of filing. It argues that since an act of Congress was required to bring tax claims within the general rule, a similar enactment would be required to create a like limitation in State Court proceedings. It must be borne in mind that such reasoning by the government is based on the fallacious premise that the ruling in

the *Saper* case was a determination that a Federal enactment was required to eliminate the payment of post-bankruptcy interest on tax claims.

Analysis of the *Saper* case discloses that the enactment of the several bankruptcy statutes was for the purpose of assimilating taxes to other debts for all purposes, including denial of post-bankruptcy interest. This Court pointed out, that for a period of fifty years the Bankruptcy Courts, in allowing post-bankruptcy interest, did so, in part, because of the existence of Section 64a of the Act of 1898 and, in part, because of an erroneous interpretation of the decision in the case of *In re Kallak*, 147 F. 276, and the line of cases stemming therefrom.

Prior to the enactment of Section 64a, the general rule limiting the payment of interest to the date of filing prevailed. At page 332, the Court stated:

> "The long-standing rule against post-bankruptcy interest thus appears implicit in our current Bankrupt Act. To read into such a statute an exception to that rule would be unwarranted and, as an original proposition, we should decline to do so."

The Court expressly found that the pertinent sections of the present-day Bankruptcy Act contain no provisions which either repudiate the established general rule, or create an exception in favor of the payment of post-bankruptcy interest.

Section 64a of the Act of 1898 reads as follows:

> "Sec. 64. Debts which Have Priority:
>
> (a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipal-

> ity in advance of the payment of dividends to creditors, * * * and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court."

As the Court pointed out, the above section created a special status for tax claims in bankruptcy. In short, a tax claim was not a claim in bankruptcy. Accordingly, since it was not required to share the bankruptcy fund with other creditors, no logical reason existed for limiting the government's claim for interest to the date of the filing of the petition. However, the creation of such special status under Section 64a, which placed tax claims in a category distinct and apart from ordinary debts, effected no change in the general rule that post-bankruptcy interest shall not be paid on debts of the bankrupt.

Section 64a of the Act of 1898 was changed by amendment, and thereafter, by the Chandler Act, until tax claims once more took their place as claims in bankruptcy along with other debts, albeit they were granted a fourth priority of payment beyond certain wage claims and administration expenses, none of which preferred claims has ever been entitled to the payment of post-bankruptcy interest.

Despite the enactment of these statutes, however, the Courts in bankruptcy, until the *Saper* case, continued to follow the practice of allowing the government post-bankruptcy interest. The reason for the continued practice lay in a misapprehension of the import of the decision in the case of *In re Kallak, supra.*

It was believed the Court, in that case, had judicially construed Section 57j, 11 U. S. C. Section 93(J). This section reads as follows:

> "S. 57(J). Proof and allowance of Claims:
>
> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty

> or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

In fact Section 57j, was not mentioned in the Court's decision. Under the mistaken belief, therefore, that Section 57j had been judicially interpreted as entitling the government to post-bankruptcy interest (when in fact, the statute the Court construed was 64a) and, despite the amendment to 64a by the Act of May 27, 1926, the import of which is hereinafter set forth, the Courts continued to allow interest to the date of payment.

Section 15 of the Act of May 27, 1926, Chap. 406, 44 Stat., 662, 666,

> "expressly provided that taxes yield priority to administration expenses and certain wages, neither of which bear interest" (p. 334).

Even after the enactment of the Chandler Act which finalized the subordination of taxes to other priority items, the practice of paying post-bankruptcy interest continued, on the theory that pre-Chandler Act allowances of interest were based on judicial construction of Section 57j which had been adopted by the Congressional re-enactment of that section in the Chandler Act.

The Court rejected this reasoning stating (p. 334):

> "If the case involved construction of any part of the Act of 1898, it clearly was S. 64(a) with its requirements of absolute priority in payment of 'all taxes legally due and owing', which, together with the dispensation from proof, the Court considered

> as indicating that taxes enjoyed a status entirely different from that accorded ordinary claims. Those provisions were considered controlling while S 57(j) was not mentioned in the opinion. Consequently, the latter section's re-enactment could not be considered a legislative adoption of any 'judicial gloss' on that section resulting from the Kallak line of cases."

The government's contention in the *Saper* case, that Section 57j created an exception to the general rule, was likewise rejected by this Court, when it said (p. 338):

> "Considered in conjunction with the general rule against post-bankruptcy interest as well as section 63's limitations of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims."

In a footnote (footnote 7, p. 330), the Court made reference to the English practice upon which this general rule was based, including two exceptions:

> "* * * if the alleged 'bankrupt' proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor, (citing cases); and if securities held by a creditor as collateral) produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest, (citing cases). These exceptions have been carried over into our system. See *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 267; *Sexton* v. *Dreyfus*, 219 U. S. 339, 346."

In a footnote (p. 338), the Court also cited the case of *Thomas* v. *Western Car Co., supra,* along with *Sexton* v.

Dreyfus, supra, and *American Iron Co.* v. *Seaboard Air Line, supra,* in support of the general rule.

In the State of New York, no law similar to Section 64a of the Act of 1898 has ever appeared on the statute books. Nothing contained in Section 3466 gives character to the contention that a Federal tax claim in connection with a State Court proceeding is not a claim in the proceeding itself. On the contrary, the section, by specific use of the word "priority", contemplates the presentation of a tax claim as a claim in the estate. There is nothing in the statute which prescribes that interest shall be paid until the date of payment. In none of the cases on the subject has Section 3466 been construed to entitle Federal tax claims to the payment of such interest. Suffice it to say at this time, the burden is on the United States of America to establish by statute or rule of law that tax claims are entitled to post-assignment interest in derogation of the general rule, as enunciated in *Thomas* v. *Western Car Co., supra; People* v. *American Loan and Trust Co., supra,* and the *Saper* case, *supra.* In the absence of such showing, it is respectfully submitted that post-assignment interest should be denied to the United States on its tax claims.

POINT VI.

The payment of post assignment interest on tax claims is not only inequitable but also contrary to the orderly administration of insolvent estates.

The Court below very aptly stated (R. 27):

> "To allow post-assignment interest on tax claims at variable and substantial rates to run on throughout the course of a lengthy assignment proceeding and thereby consume all or much of the funds avail-

able, to the detriment of the other creditors, is in accord with neither law nor equity."

It requires very little analysis to recognize the unfairness resulting from the practice urged by petitioner. The funds in the hands of an assignee are available to all creditors. Out of that fund are paid administration expenses, secured claims, unsecured claims including federal, state and local government claims, other priority claims, such as wage claims, and the balance of unsecured claims, that is, if the fund is large enough. If not, the unsecured creditors without priority stand to lose—a result in no way connected with any act on their part. The interest the government demands because of delay in the payment of its claims accrues through no fault of the creditors. Manifold reasons for delay can be cited. In the case at bar, a considerable portion of the assets consisted of accounts receivable which respondent had to liquidate over a period of many months resulting in unavoidable delay.

Frequently, controversies arise as to the merits of filed claims determined only after appeals. Often, the assignor is entitled to a tax refund which cannot be accomplished overnight. If a tax claim of the government is successfully objected to, clearly, the government itself has been the cause of the delay. In the instant case, appeals instituted by the Petitioner and the State of New York, have delayed a final distribution in the estate. Can it be urged in good conscience that, regardless, the government shall receive not only a preference on accrued interest and principal but, in addition, interest upon the entire claim while the property of the estate is in *custodia legis?* To propound the question is to answer it. If, as Petitioner contends, there is a rule permitting the practice then it should never have been permitted to come into existence in the first place.

Common sense dictates that interest should cease to run upon the filing of the proceedings.

CONCLUSION.

The cited sections relied upon by the United States create no mandate for the payment of interest in assignment proceedings up to the date of payment of the tax. There being no federal statute to the contrary, the common law rule against post assignment interest is applicable herein and the Lower Court committed no error in so holding.

Respectfully submitted,

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